No. 15310

In the United States Court of Appeals for the Ninth Circuit

SUNLAND INDUSTRIES, INC., a Corporation, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLEE

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OPINION BELOW

The findings of fact and conclusions of law of the District Court (R. 46-56) are not officially reported.

JURISDICTION

This appeal involves federal excess profits taxes for the year 1943, with interest, in the amount of $78,130.71. The taxes in dispute were paid on December 14, 1949. (R. 5, 34.) Claim for refund was filed on December 23, 1949 (R. 5, 35) and was rejected (R. 35-36). Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on May 1, 1952, the taxpayer brought an action in the District

Taxpayer filed consents extending to June 30, 1949, the time for assessment for 1943. (R. 49.) By letter dated December 1, 1949, taxpayer was advised by the Internal Revenue Agent in Charge, San Francisco, that a constructive average base period net income of $32,958.62 was being allowed for the years 1941, 1942, 1943 and 1945. (R. 50.) This was far less than the amount claimed by taxpayer in its application for relief for 1943, filed in 1946, and meant that any claim for relief under Section 722 was denied in full for 1943. (R. 51.) On December 14, 1949, in order to stop the running of interest, taxpayer paid a deficiency of $55,989.09 in excess profits tax for 1943, plus interest of $19,316.23 (R. 49), accompanied with a statement to the effect that taxpayer did not waive its right to claim that such payment was untimely (R. 50). Taxpayer duly filed a claim for refund of this payment. (R. 49.)

On January 23, 1950, the Excess Profits Tax Council approved the finding of the Internal Revenue Agent in Charge relating to the determination of taxpayer's constructive average base period net income. (R. 53.) The deficiency in excess profits tax for 1943, and interest, was assessed on the January, 1950, list. (R. 49.) The statutory notice of deficiencies was sent by the Commissioner to the taxpayer on April 6, 1950. (R. 50.)

In this proceeding taxpayer claims that the assessment was untimely, being barred by the three-year statute of limitations of Section 275(a) of the Internal Revenue Code of 1939, as extended to June 30, 1949, by consents filed under Section 276(b). The court below held that the assessment was timely, falling within the provision of Section 701(a)(5) that any amount of tax

remaining unpaid under that paragraph in excess of the reduction in tax finally determined under Section 722 may be assessed at any time before the expiration of one year after such final determination. (R. 54-55.)

SUMMARY OF ARGUMENT

I

Under Section 710(a)(5) of the Internal Revenue Code of 1939, a taxpayer who files a claim for relief for excessive profits taxes under Section 722 may defer payment of excess profits tax equal to 33 per cent of the reduction claimed until determination of his claim for relief. The Commissioner has one year after the final determination of the claim for relief to assess the amount of the deferment as to which the taxpayer has not obtained relief.

Taxpayer here by an informal claim on its 1943 excess profits tax return claimed relief under Section 722 and deferred a part of its tax for that year. Although the claim was formally defective in not complying with the Regulations, the Commissioner treated it as an effective informal claim and taxpayer perfected it by filing a formal claim. Taxpayer now claims that the Commissioner lacked power to waive the formal defects.

It is completely settled, however, by Supreme Court decisions, that the Commissioner has the power to waive his procedural Regulations, and that a course of departmental action such as occurred here is such a waiver.

II

Taxpayer, having filed an informal claim and treated it ~~is~~ as one subject to perfection by the filing of a formal claim, cannot now deny its effectiveness. Having enjoyed the benefits of the deferment it cannot now say that the deferment was erroneous and that the section of the statute which it successfully invoked was inapplicable. To permit it to do so would be for the courts to assist the taxpayer in taking advantage of its own wrong.

III

The District Court announced its decision prior to receipt of taxpayer's reply brief. Thereafter it fully reconsidered the matter, and its findings of fact, conclusions of law, and judgment were issued after that reconsideration. Again, on motion for new trial it once more reviewed the matter. Under these circumstances there was clearly no reversible error.

ARGUMENT

I

The Commissioner of Internal Revenue Had the Power to Treat the Informal Claim on Taxpayer's 1943 Return, Perfected by the Timely Filing of a Formal Claim, as a Properly Filed Claim

Section 722 of the World War II Excess Profits Tax Act, added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, and amended by Section 222, Revenue Act of 1942, c. 619, 56 Stat. 798, provides that in any case in which a taxpayer establishes that the tax otherwise computed results in an excessive and discriminatory tax and establishes what would be a fair

and just amount representing normal earnings to be used as a constructive average base period net income for excess profits tax purposes, the tax shall be determined by using such constructive average base period net income. It authorizes the taxpayer to apply for an administrative determination that he is entitled to relief.

If he is granted relief under Section 722 such as to entitle him to a refund, Section 3771(g) of the Code, added by Section 2, Act of December 17, 1943, c. 346, 57 Stat. 601, limits his right to interest on the refund. Therefore, the relief granted by Section 722 is insufficient to compensate him, pending the administrative determination of his application, for the loss resulting from the withholding of money he is eventually entitled to have returned. Accordingly, to guard against this potential loss Section 710(a)(5) (Appendix, *infra*) enables the taxpayer to retain the use of one-third of the Section 722 reduction for which he has applied, pending the administrative determination. See *Squire* v. *Puget Sound Pulp & Timber Co.,* 181 F. 2d 745 (C.A. 9th).

As originally enacted by Section 222(b) of the Revenue Act of 1942, *supra,* Section 710(a)(5) was silent as to the relationship of this section to the statute of limitations. If the Commissioner were to assess a deficiency for the amount deferred within the general three-year period of limitations but prior to final determination of the application for relief under Section 722, he would render the relief provided by Section 710(a)(5) ineffective. *California Vegetable Concentrates, Inc.* v. *Commissioner,* 10 T.C. 1158.

By Section 3 of the Joint Resolution of June 12, 1948, c. 459, 62 Stat. 387, Congress added the provision, effective retroactively, that—

> Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under section 722, such excess may be assessed at any time before the expiration of one year after such final determination.

It is the application of that provision which is in controversy here.

There is here no dispute as to the amounts in question, nor as to the date of the final determination, nor as to the fact that the deficiency was assessed within the time limits of this provision, if it is applicable. See *Hardaway Motor Co.* v. *Commissioner,* 207 F. 2d 872 (C. A. 5th); *Tribune Publishing Co.* v. *Commissioner,* 17 T. C. 1228. Taxpayer's argument, as we understand it, is that it did not comply with the procedure set out in the Regulations for claiming Section 710(a)(5) deferment, and was not entitled to the benefits of that section. Since, although it actually received the benefit of deferment, it was not entitled to do so, the section was not really applicable at all. Since the section was inapplicable, the extended statute of limitations contained therein was inapplicable.

Section 35.710-5 of Treasury Regulations 112 provides in part that a taxpayer claiming deferment under Section 710(a)(5) must, at the time of filing its excess profits tax return, attach thereto an application for relief under Section 722 in Form 991:

> The application must set forth under oath each ground under section 722 upon which the applica-

> tion for relief is based and facts sufficient to apprise the Commissioner of the exact basis thereof and to establish eligibility for relief, as well as data and information in sufficient detail to establish the amount of constructive average base period net income claimed, the amount of tax reduction claimed, by the use of section 722, and the amount of tax deferment claimed on the return. In any case in which an application for relief on Form 991 (revised January, 1943) is not so attached to the excess profits tax return, the taxpayer shall not be deemed to have claimed on its return the benefits of section 722.

Taxpayer on or about September 15, 1943, had filed, on Form 991, an application for relief under Section 722 for its taxable year 1942. (R. 19, 71-75) It did not attach a Form 991 to its return for 1943, the year here involved. On its excess profits tax return for that year (R. 63-66), under Item 17, "Amount deferred by reason of the application of section 710(a)(5) (relating to abnormality under section 722) (attach schedule)" it wrote in "in accordance claim on file 1942 * * * $63,768.68" (R. 63), referring to the foregoing application for relief filed on September 15, 1943 (R. 19). Subsequently, on March 12, 1946, prior to the expiration of the general statute of limitations for assessing deficiencies in excess profits tax for the year 1943, taxpayer filed a claim for relief under Section 722 for the year 1943, using Form 991. (R. 20, 77-81.)

It is obvious that the notation under Item 17 of the 1943 return, defective though it was, was intended as a claim for relief under Section 722 and as a claim of a right to defer payment of a portion of the tax under

Section 710(a)(5). It was defective in not having attached Form 991, and erroneous in misconstruing the amount of tax which taxpayer was entitled to defer. Nevertheless it was a claim and can be construed to be nothing less than an informal claim.

It is equally obvious that it was so treated by the Commissioner. The remaining liability shown on the return was assessed and collected prior to July 1, 1949 (R. 17), the date to which the time for assessing tax liability had been extended by consents filed under Section 276(b) (R. 25, 26). Adjustments to this amount had been suggested by Revenue Agents. (R. 17.) The tax return had been audited prior to May 25, 1948 (R. 27), and the Revenue Agent's report referred to the deferment (R. 28). An internal memorandum of December 9, 1948, also referred to the Section 710(a)(5) deferments. (R. 29.)[1]

The notation on the return was intended as a claim, and was later perfected by a formal claim. The Commissioner in fact treated it as a valid though informal claim. Accordingly we come down to the question whether the Commissioner had the power to treat this informal claim as a proper claim entitling taxpayer to defer payment of a portion of its excess profits tax.

There is, however, no real question as to this. It has been thoroughly settled by Supreme Court decisions that the Commissioner does have such power. Indeed the decisions go far beyond the issue presented in this case, to hold that the Commissioner not only has the power but has validly exercised it even in cases where

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[1] These facts are stipulated. Taxpayer (Br. 22) objects to use of the facts on pages 27-29 of the record to show an estoppel. However reference to them to show what the Commissioner in fact did is clearly within the terms of the stipulation.

the formal claim has been filed after the expiration of the statute of limitations.

The Court in *United States* v. *Felt & Tarrant Co.*, 283 U. S. 269, 273, stated that compliance with formal requirements "may be dispense with by waiver, as an administrative act," citing *Tucker* v. *Alexander*, 275 U. S. 228. In *United States* v. *Garbutt Oil Co.*, 302 U. S. 528, 533, in holding that an amendment of a claim by setting out new grounds was in effect a new claim, barred because the amendment was made after the statute of limitations had run, the Court distinguished between the Commissioner's lack of power to disregard the statutory mandate and "his undoubted power to waive the requirements of the Treasury regulations." Referring to *United States* v. *Memphis Cotton Oil Co.*, 288 U. S. 62, the Court said (302 U. S. 528, 533):

> In the cited case, and others decided about the same time, we held that, while the Commissioner might have enforced the regulation and rejected a claim for failure to comply with it in omitting to state with particularity the grounds on which the claim was based, he was not bound to do so, but might waive the requirement of the regulation and consider a general claim on its merits.

See also, *Bonwit Teller & Co.* v. *United States*, 283 U. S. 258; *United States* v. *Memphis Cotton Oil Co.*, 288 U. S. 62; *Bemis Bro. Bag Co.* v. *United States*, 289 U. S. 28; *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373; *Angelus Milling Co.* v. *Commissioner*, 325 U. S. 293, 297, 298. See also *Abe M. Katz Co.* v. *United States*, 193 F. 2d 510 (C. A. 5th), dealing with a claim filed under Section 710(a)(5), where it was assumed

that a claim filed at some time after filing the return, and then returned for corrections of defects, was a valid claim.

The cases cited by taxpaper (Br. 10-11, 14) are readily distinguishable. The Regulations involved in *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90; *Douglas* v. *Commissioner,* 322 U. S. 275, and *Guanacevi Mining Co.* v. *Commissioner,* 127 F. 2d 49 (C. A. 9th), dealt with substantive, not procedural, matters, which also were not waived by the Commissioner. *Lucas* v. *Pilliod Lumber Co.,* 281 U. S. 245, held that formal requirements set out in the statute, not in Regulations, may not be waived by the Commissioner. In *Commissioner* v. *Lane-Wells Co.,* 321 U. S. 219, the Commissioner was insisting upon, not waiving, the requirements of the Regulations.[2]

II

Taxpayer, Having Obtained the Benefits of an Informal Claim, May Not Now Assert That It Was Ineffective

Taxpayer (Br. 17-27) objects to the finding of the District Court (R. 53-54) that—

> The reference to the 1942 claim together with the taxpayer's own course of conduct served to mislead the Commissioner to the extent that the taxpayer should not be allowed to take advantage of any error on the Commissioner's part.

and to the corresponding conclusion of law (R. 55).

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[2] If it be argued that the decisions have involved cases where the taxpayer has attempted to establish a waiver, whereas here it is the Commissioner, we do not see how the Commissioner's power to waive procedural requirements is less when he is claiming the power than when it is being forced on him.

In the first place, taxpayer argues that what was involved here was no more than in the ordinary statute of limitations case, where a taxpayer has omitted something or made an error in his return, and that such omissions or errors do not lead to an estoppel. (Br. 17-21.) This argument, however, misunderstands the issue. The question is not whether taxpayer was or was not in fact entitled to relief or whether it was in fact entitled to deferment of the *amount* of tax it withheld. The question is whether taxpayer was representing that it was making a *claim* for relief, from which would follow its right to defer payment of a part of the tax. It clearly was doing this.

As the findings and conclusions of the court below hold, the reference to the 1942 claim and its course of conduct served to mislead the Commissioner. Included in that course of conduct was the subsequent filing of the formal claim for relief on Form 991. The notation on the 1943 excess profits tax return in the space provided for claims for deferment under Section 710(a)(5), the entry of an amount deferred, the reference to the 1942 claim for Section 722 relief, the subsequent perfecting of the informal claim, all were a representation to the Commissioner that taxpayer was claiming relief under Section 722 and was asserting the corresponding right to defer part of the tax under Section 710(a)(5). This was a representation as to taxpayer's then state of mind, its belief that it had a valid claim.

If taxpayer intended, after the expiration of the general statute of limitations, with the Commissioner not having assessed a deficiency in the amount deferred, to deny the effectiveness of its claim and

dispute its right to defer payment, that was a fact which the Commissioner had no means of discovering, being solely within taxpayer's knowledge. As matters apparently stood, with a claim on file which taxpayer and Commissioner alike treated as valid, the Commissioner could not assess a deficiency until final determination of the claim for Section 722 relief. *California Vegetable Concentrates, Inc.* v. *Commissioner,* 10 T. C. 1158.

Taxpayer by its actions represented that it had a claim sufficient to justify deferment under Section 710 (a)(5). It in fact did have such a claim, the informality having been disregarded by the Commissioner. The Commissioner acted upon the basis of a claim having been filed by taxpayer. Taxpayer's argument now is that the representations implicit in its conduct were false, and that it did not in fact have a valid claim. This is not a case of error in the factual details of a claim, but one of denying the existence of any claim. We submit that the court below properly held that taxpayer cannot be allowed to take advantage of any error on the Commissioner's part (R. 54, 55), although as we have stated in Point I, we do not believe that the Commissioner made any error. However, if it be held that the Commissioner should have assessed the deficiency prior to July 1, 1949, it is clear that his failure to do so resulted from taxpayer's representation that it was claiming relief under Section 722, and that for taxpayer now to deny that it had a claim would be for it to take advantage, not of its error, but of its wrong.

In the second place taxpayer argues that the court was precluded from considering the foregoing

because technical estoppel was not pleaded as an affirmative defense under Rule 8(c) of the Federal Rules of Civil Procedure. (Br. 20-24, 29-30.) Taxpayer asserts that the reasons why it must be affirmatively pleaded are that the defendant must plead and prove each element of a recognized defense and that a plaintiff must be given an opportunity to present evidence contradicting the effect of the purported defense. (Br. 22.)

We respectfully submit that the facts of this case do not call for the strict application of Rule 8(c), and that the failure of the court below to hold that the answer must contain a section entitled "Affirmative Defense" is, if error, at most harmless error. There was no surprise to the taxpayer or doubt as to the contentions of the Government. The conclusion that there was an estoppel followed as a matter of law from the stipulated facts (R. 18, 20),[3] and taxpayer does not even now suggest what additional evidence could be available, or in fact that there is anything further it could say to strengthen its position. In this situation Rule 8(c) should be construed in the light of the admonition in Rule 1 that the rules "shall be construed to secure the just, speedy, and inexpensive determination of every action."

Furthermore, it is up to the taxpayer to establish his

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[3] Further facts supporting the result below are set out in Paragraph VII of the Stipulation (R. 26-33), which taxpayer asserts may not be considered for this purpose. While we believe that the terms of the stipulation (R. 26-27) are broad enough to permit their consideration, the uncontested parts of the stipulation furnish sufficient support for the court's conclusion.

right to a refund. In language quoted in *Lewis* v. *Reynolds,* 284 U. S. 281, 283—

> the taxpayer, nevertheless, is not entitled to a refund unless he has overpaid his tax. The action to recover on a claim for refund is in the nature of an action for money had and received, and it is incumbent upon the claimant to show that the United States has money which belongs to him.

See also *Roybark* v. *United States,* 218 F. 2d 164 (C. A. 9th). There is no dispute here as to the fact that the amount paid represented taxpayer's correct tax liability.

Finally, although the elements of estoppel are present, we believe that the court's Conclusion IV also reflects a more fundamental principle than that of technical estoppel—the principle that the courts will not lend their aid to the perpetuation of a wrong. "The plaintiff cannot be permitted to found its claim upon his own inequity or to take advantage of its own wrong." (R. 55.)[4] See *Stearns Co.* v. *United States,* 291 U. S. 54, 61-62.

III

The District Court's Announcement of Its Decision Prior to Receipt of Taxpayer's Reply Brief, Where the Matter Was Then Fully Reconsidered, Was, at Most, Harmless Error

Taxpayer objects that the court below announced its decision prior to receipt of taxpayer's reply brief. (Br. 27-29.) Although it appears that counsel were advised

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[4] Although not directly involved here, the congressional policy against a change of position by either taxpayer or Commissioner is reflected in Sections 1311-1314 of the Internal Revenue Code of 1954.

by the clerk that the court had decided the case on March 23, 1956 (R. 39-40, 45-46), prior to receipt of taxpayer's reply brief on March 27 (R. 40-41), the error, if it was error, was harmless.

Subsequent to that time, and before final judgment, the court considered the arguments presented by taxpayer. Its order of April 16, 1956, overruling taxpayer's objection to introduction of evidence specifically refers to the reply brief. (R. 44.) A supplemental stipulation of facts was filed on May 2. (R. 45-46.) The findings of fact, conclusions of law, and judgment were not filed until April 18. (R. 46-56.) On June 1, the court granted in part and denied in part taxpayer's motion to amend and supplement the findings of fact and conclusions of law. (R. 57-59.) On the same day the court, having considered the files, the evidence, the memoranda and argument of counsel, denied taxpayer's motion for a new trial. (R. 59.)

On this record it is clear that taxpayer, before final decision, was granted a full opportunity to present its arguments to the court, and that it was not prejudiced by the court's first action. Certainly there has been shown no such abuse of the trial court's discretion in the manner of conducting its business as to call for supervisory action by this Court. Too, it is not clear just what action by this Court taxpayer is requesting, since upon a remand there is nothing additional for the District Court to consider which was not before it before it rendered its judgment.

Finally, taxpayer suggests that since the facts were stipulated this Court is free to disregard the findings of the District Court. (Br. 30-31.) We do not know which findings taxpayer wishes to have disregarded,

but in any event the rule so asserted is subject to the qualifications expressed by this Court in *Randall Foundation, Inc.* v. *Riddell,* decided January 18, 1957, (1957 P-H, par. 72,429) and *Rollingwood Corp.* v. *Commissioner,* 190 F. 2d 263.

CONCLUSION

The decision of the court below is correct. It should be affirmed.

Respectfully submitted,

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MARCH, 1957.

APPENDIX

Internal Revenue Code of 1939:

Sec. 275. Period of Limitation Upon Assessment and Collection.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

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(26 U.S.C. 1952 ed., Sec. 275.)

Sec. 276. Same—Exceptions.

*　　*　　*　　*　　*

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

*　　*　　*　　*　　*

(26 U.S.C. 1952 ed., Sec. 276.)

Sec. 710 [as added by Section 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. Imposition of Tax.

(a) *Imposition.*—

*   *   *   *   *

(5) [as added by Section 222(b), Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Section 3(a), Joint Resolution of June 12, 1948, c. 459, 62 Stat. 387] *Deferment of payment in case of abnormality.*—If the adjusted excess profits net income (computed without reference to Section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, the benefits of Section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in Section 26(e) (relating to adjusted excess profits net income), the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the purposes of Section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return. Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under Section 722, such excess may be assessed at any time before the expiration of one year after such final determination.

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(26 U.S.C. 1952 ed., Sec. 710.)

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